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SUBJECT: DEBT PROBLEMS OF DEVELOPING COUNTRIES

1. DEVELOPING COUNTRY SPOKESMEN CONTINUE TO EMPHASIZE THE
"DEBT PROBLEM" AS A MAJOR ISSUE IN THE NORTH-SOUTH DIALOGUE.
WE APPRECIATE LDC CONCERN ON DEBT ISSUE, AND WOULD BE IN-
TERESTED IN THE DETAILED VIEWS OF KEY LDCS. REQUEST YOU
INITIATE DIALOGUE WITH APPROPRIATE HOST GOVERNMENT OFFICIALS
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ON SUBJECT OF EXTERNAL DEBT AND REPORT THEIR VIEWS IN AS

MUCH DETAIL AS POSSIBLE.

2. BACKGROUND

A. ELIGIBILITY FOR DEBT RELIEF HAS TRADITIONALLY BEEN BASED ON A "CASE-BY-CASE" EXAMINATION OF INDIVIDUAL DEBT PROBLEMS AS THEY ARISE. SINCE 1956, THERE HAVE BEEN APPROXIMATELY 35 INTERNATIONAL AGREEMENTS NEGOTIATING DEBT RELIEF FOR 13 COUNTRIES.

AS A RESULT OF THE SERIOUS ECONOMIC DIFFICULTIES WHICH THEY CONFRONT, SOME LDCS NOW VIEW DEBT RELIEF PRIMARILY IN THE CONTEXT OF:

--A VEHICLE FOR PROVIDING BALANCE OF PAYMENTS RELIEF AND/OR;

-- A MEANS OF SUPPLEMENTING WHAT THEY CONSIDER TO BE INADEQUATE FLOWS OF DEVELOPMENT ASSISTANCE.

B. IT NOW APPEARS THAT THE UNCTAD SECRETARIAT WITH GROUP 77 BACKING WILL MAKE DEBT ONE OF THE MAJOR ISSUES AT NAIROBI. IN THIS CONTEXT, SPECIFIC LDC PROPOSALS ARE LIKELY TO ADVOCATE:

-- GENERALIZED (AS DISTINGUISHED FROM THE CURRENT "CASE-BY-CASE" APPROACH) DEBT RELIEF, PARTICULARLY FOR THE MSAS.

-- BROAD INTERNATIONAL MEASURES TO ALLOW COUNTRIES WITH A LARGE VOLUME OF COMMERCIAL DEBT TO LENGTHEN THE MATURITY OF SUCH DEBT. SUCH MEASURES MAY INCLUDE THE ESTABLISHMENT OF A MULTILATERAL FINANCIAL INSTITUTION DESIGNED TO FUND THE SHORT-TERM DEBT OF THE LDCS.

-- THE CONVENING OF AN INTERNATIONAL CONFERENCE ON DEBT. THE SEVENTH SPECIAL SESSION OF THE UNGA SPECIFICALLY REQUESTED UNCTAD TO CONSIDER THE POSSIBILITY OF SUCH A CONFERENCE.

C. IT IS UNCERTAIN WHETHER THE LDCS ACTUALLY HOPE TO LIMITED OFFICIAL USE

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GAIN SOME OF THE OBJECTIVES THEY ARE ESPOUSING, OR WHETHER THEIR RISING DEMANDS ON DEBT ARE PRIMARILY PART OF A STRATEGY AIMED AT ENHANCING THEIR OVERALL "BARGAINING POSITION" AT UNCTAD IV.

IN ASSESSING LDC EXPECTATIONS, SEVERAL FACTORS SHOULD BE NOTED:

-- THE MAJOR CREDITORS HAVE GIVEN THE LDCS NO INDICATION THEY ARE WILLING TO CONSIDER ABANDONING THE "CASE-BY-CASE" APPROACH. (THE NETHERLANDS AND SWEDEN HAVE, HOWEVER, BEEN OUTSPOKEN ADVOCATES OF A DEBT MORATORIUM FOR THE MSAS.)

-- THE "GROUP OF 77" POSITIONS ON DEBT REFLECT TO A LARGE EXTENT THE VIEWS OF UNREPRESENTATIVE BUT ACTIVIST LDCS. INDIA, FOR EXAMPLE, ACCOUNTS FOR MORE THAN 50 PERCENT OF 1976 DEBT SERVICE OWED BY THE MSAS AND IS A MAJOR FORCE IN G-77 ADVOCACY OF GENERALIZED RELIEF FOR THE MSAS.

-- THE MORE ADVANCED LDCS, DEPENDENT ON PRIVATE FLOWS FOR THE BULK OF THEIR EXTERNAL CAPITAL, ARE RELUCTANT TO JEOPARDIZE THEIR CREDITWORTHINESS. THUS, ALTHOUGH THEY

CONFRONT THE MOST IMMEDIATE DEBT PROBLEMS, THEY ARE LEAST LIKELY TO ENDORSE GENERALIZED DEBT RELIEF. SOME OF THESE LDCS MAY ALSO BE UNENTHUSIASTIC ABOUT A SPECIAL DEBT CONFERENCE, REALIZING THAT AN UNSUCCESSFUL CONFERENCE COULD HAVE HAVE ADVERSE EFFECTS IN INTERNATIONAL CAPITAL MARKETS.

D. USG AUTHORITY TO RESCHEDULE DEBTS IS RESTRICTED BOTH BY LEGAL PROVISIONS AND BY CONGRESSIONAL ATTITUDES ON DEBT RELIEF. UNLESS DEBT RELIEF CAN BE CAREFULLY JUSTIFIED ON A CASE-BY-CASE BASIS, WE BELIEVE CONGRESS WOULD REDUCE THE FLEXIBILITY OF THE EXECUTIVE BRANCH TO DEAL WITH FOREIGN DEBT PROBLEMS. THUS IF WE WERE TO ATTEMPT TO USE DEBT RELIEF AS A METHOD OF AVOIDING BUDGETARY APPROPRIATIONS (E.G. BY INCREASED USE OF DEBT RELIEF AS A FORM OF AID) WE BELIEVE IT WOULD BE SELF-LIMITED OFFICIAL USE

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DEFEATING.

THE UNITED STATES THEREFORE SEEKS TO:

-- MAINTAIN DEBT REPAYMENT SCHEDULES AGREED UPON WHEN CREDITS EXTENDED;

-- ENCOURAGE APPROPRIATE ECONOMIC POLICIES WHICH WOULD ENABLE COUNTRIES TO MEET DEBT OBLIGATIONS;

-- ESTABLISH THAT DEBT RELIEF IS NOT AN APPROPRIATE INSTRUMENT FOR EITHER ALLEVIATING CURRENT BALANCE OF PAYMENTS DIFFICULTIES OR PROVIDING DEVELOPMENT ASSISTANCE;

-- DETERMINE ELIGIBILITY FOR RELIEF ON A "CASE-BY-CASE"

BASIS;

-- AVOID AN INTERNATIONAL CONFERENCE THAT WOULD FOCUS ON DEBT RELIEF AS A METHOD OF PROVIDING GENERAL BALANCE OF PAYMENTS SUPPORT TO THE LDCS.

4. GIVEN ITS IMPORTANCE, WE BELIEVE A FRANK EXCHANGE OF VIEWS WITH KEY LDCS ON THE DEBT ISSUE WOULD BE MUTUALLY BENEFICIAL. WE ARE PARTICULARLY INTERESTED IN THEIR ASSESSMENT ON BOTH THE CURRENT SITUATION AND THE TREATMENT OF DEBT IN UNCTAD IV.

5. IN YOUR DISCUSSIONS WITH HOST GOVERNMENT OFFICIALS, YOU SHOULD TREAT THE DEBT PROBLEM WITHIN THE BROADER CONTEXT OF LDC FINANCING PROBLEMS. THE FOLLOWING POINTS SHOULD BE HIGHLIGHTED:

-- AS WE SEE IT, A NUMBER OF DEVELOPING COUNTRIES ENTERED 1976 VULNERABLE TO DEBT SERVICING DIFFICULTIES. THESE COUNTRIES WERE PRIMARILY THE MORE ADVANCED LDCS WHO HAD BORROWED HEAVILY IN PRIVATE CAPITAL MARKETS IN ORDER TO FINANCE LARGE CURRENT ACCOUNT DEFICITS IN THEIR BALANCE OF PAYMENTS. ALTHOUGH A MODEST BALANCE OF PAYMENTS IMPROVEMENT IS PROJECTED FOR THE NON-OIL LDCS IN 1976, THE DEFICIT WILL STILL BE EXTRAORDINARILY LARGE AND WILL REQUIRE HEAVY EXTERNAL FINANCING.
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-- WE ARE VERY MUCH AWARE OF THE IMPORTANCE THE BORROWERS OF PRIVATE CAPITAL ATTACH TO MAINTAINING THEIR "CREDITWORTHINESS". WE ALSO APPRECIATE THE CONCERN HELD BY SUCH BORROWERS AT THEIR DEPENDENCE ON THE CONTINUED AVAILABILITY OF PRIVATE CAPITAL. IN THIS CONNECTION, WE RECOGNIZE THE IMPORTANCE OF HAVING ADEQUATE CONTINGENCY FINANCING AVAILABLE FOR BALANCE OF PAYMENTS SUPPORT.

-- PRIOR TO THE RECENTLY CONCLUDED INTERIM COMMITTEE MEETING OF THE IMF, WORK WAS ALREADY UNDERWAY TO PROVIDE LDCS WITH ADDITIONAL SOURCES OF FINANCING IN 1976. IN THE RECENT MEETING DECISIONS WERE MADE THAT EXPANDED THE AVAILABILITY OF IMF FINANCING TO LDCS. THIS FINANCING PROVIDES TEMPORARY FINANCIAL SUPPORT TO ENABLE COUNTRIES TO MAKE NECESSARY INTERNAL ADJUSTMENTS.

-- THESE MEASURES MAY ALSO TEND TO INCREASE THE CREDIT-WORTHINESS OF MANY LDCS IN THE EYES OF PRIVATE BANKERS. GIVEN THESE NEW RESOURCES, THERE IS SOME REASON TO BE OPTIMISTIC THAT -- WITH A FEW POSSIBLE EXCEPTIONS --

AVAILABLE FINANCIAL MECHANISMS WILL BE ADEQUATE TO COPE WITH THE AGGREGATE 1976 LDC DEFICIT AS WELL AS THE FINANCING PROBLEMS WHICH MAY ARISE FOR A SUCCESSION OF WEAKER COUNTRIES.

-- THE MSAS CONSTITUTE A DISTINCT PROBLEM. WE ARE SYMPATHETIC TO THEIR PLIGHT, AND BELIEVE EFFORTS TO ALLEVIATE THEIR FINANCING DIFFICULTIES MUST FOCUS ON IMPROVING AND EXPANDING NEW CONCESSIONAL AID FLOWS RATHER THAN GENERALIZED DEBT RELIEF. VERY FEW OF THE MSAS HAVE A LARGE ACCUMULATION OF DEBT, AND MOST -- PARTICULARLY THE SMALLER -- WOULD RECEIVE ONLY MARGINAL GAIN FROM DEBT RELIEF.

-- WE ARE INCREASINGLY CONCERNED THAT THE PROPOSALS STATED IN PARA 2(B) COULD HAVE AN ADVERSE EFFECT ON THE TRADITIONAL CREDITOR-DEBTOR RELATIONSHIP, AND THEREBY

COULD AFFECT ADVERSELY ON THE LONG-TERM FLOW OF RESOURCES LIMITED OFFICIAL USE

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TO DEVELOPING COUNTRIES. INGERSOLL

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